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<p><del>memo</del> w/att.</p>	<p><del>From Michael Blumenthal to The President RE:</del>  <del>Orderly Market Arrangement (14 pp.) enclosed</del>  <del>in Hutcheson to Blumenthal et al. 5/19/77</del></p> <p>OPENED 1/18/13</p>	<p>5/18/77</p>	<p>A</p>

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THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Stu Eizenstat -

The attached was returned in the  
President's outbox and is forwarded  
to you for your information.

Rick Hutcheson

Re: Secretary Blumenthal's memo  
(undated) re: Possible Tax  
Reform Program



THE SECRETARY OF THE TREASURY  
WASHINGTON 20220

*Shu J*

THE PRESIDENT HAS BEEN

MEMORANDUM FOR THE PRESIDENT

Subject: Possible Tax Reform Program

I. Simplification for the Average Taxpayer

We have two suggestions for simplifying the tax system for the average taxpayer. The first one is summarized in chart 9.

A. Restrict Itemized Deductions

The idea here is to reduce or eliminate itemized deductions and in this way simplify return computations. The elimination of these deductions would be more than offset by rate reductions. The items suggested for elimination are shown in chart 11 and are those where the items either tend to be relatively small or where there is a lot of guessing in computing the deductions.

In the case of state and local taxes, it is suggested that we eliminate the deduction for gasoline taxes, for sales taxes and miscellaneous taxes. This would raise \$2.4 billion in revenue.

Present law provides a table from which individuals compute their gasoline tax, depending upon how many miles they ran their car during the year. This ignores the difference in gas consumption of different cars and also ignores whether the driving is city driving or long-distance driving. These variations make an enormous difference. In addition, it is necessary to know the mileage on the car at the beginning and end of the year in order to determine the miles driven. Few people check their mileage on January 1, which means that this is largely a guessing game and taxpayers are tempted to overstate their deductions. Data available suggests that the overstatement is on the average at least 20 percent.

No change is made in the two really important tax deductions--the state income tax deduction and the real property tax deduction.

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for Preservation Purposes**

Under present law, the intent in the case of medical expenses was to allow only extraordinary expenses. The casualty loss deduction has a similar purpose. But the 3-percent floor on the medical expense has become too low a test of what is an extraordinary medical expense. Medical expenses now represent a larger portion of total consumer expenditures than was previously the case.

It is suggested that medical expenses be combined with casualty losses but that deductions only be allowed where the combined total is truly extraordinary--namely, over 10 percent of AGI. Prescription drugs would count for this purpose as would medical insurance premiums, but no medical premiums would be deductible except as they exceed the extraordinary expense limitation. The category would probably be renamed "extraordinary personal expenditures." This should raise about \$1.3 billion in revenues.

In addition, it is suggested that mortgage and other personal interest be included in the present limitation on deductible investment interest--investment income plus \$10,000. This would still leave as a deductible item interest on a mortgage of \$110,000 at a 9 percent interest rate. This will raise about \$100 million in revenues.

These items in total would raise about \$3.8 billion, but taxpayers would be more than compensated for them by rate reductions. With these changes in the deductions, the itemized computations should be far simpler than under present law but taxpayers, except in rare cases, will not be disadvantaged by the shifts.

B. Convert the Personal Exemption and General Tax Credit to a Single Credit

A second simplification would substitute a \$200 credit for the present \$750 exemption and \$35 credit (or 2 percent of the first \$9,000 of taxable income, whichever is the greater). The \$200 credit is a rate reduction for those below the 22-percent rate bracket and, if nothing else were done, an increase for those above this bracket rate.

This provides a tax reduction of \$833 million for those with adjusted gross incomes of \$10,000 or less. There will also be reductions above that level, but on balance the next income category shows a slight increase. Overall, the tax

increase from converting the personal exemption and general credit to the \$200 credit results in a revenue gain of about \$6.5 billion. Rate reductions in the upper brackets would much more than offset this increase. The \$15, \$30, or \$45 credits for energy would be added to this.

## II. Capital Gains and Losses

Capital gains now are taxed at roughly half the regular individual tax rates--7 percent to 35 percent, but the first \$50,000 of gain is taxed at not over 25 percent. The minimum tax applies to the excluded half of capital gains bringing the maximum rates up to about 40 percent. The limitation on earned income also has the effect of bringing the maximum tax rate on earned income up still further to 49-1/8 percent.

It is suggested that capital gains generally be taxed as ordinary income. This means the rate of tax would range from 13 percent to 50 percent. The substantial rate reduction on ordinary income limits the size of this tax increase, but there still would be an increase of about \$4.4 billion. For individuals a quarter of the increase is in the income class over \$200,000 and about 60 percent are in the income levels over \$50,000. As a result, this is concentrated in the very range where most of the relief would be provided by a 50 percent maximum rate. Over three-quarters of the increase is in the income categories over \$30,000.

Eliminating the special tax category for capital gains will be a major simplification of the tax law. Ttable 1 shows six pages of provisions in the present law which can either be eliminated or substantially cut down if capital gains is removed from special treatment. Tax practitioners devote a major part of their time to try and cast transactions in a form which will result in capital gains rather than ordinary income. Also, a large portion of the tax cases in the courts are concerned with whether income is capital gain or ordinary income. All of this would be eliminated if the separate distinction for capital gains were removed.

If capital gains are to be taxed as ordinary income, capital losses, other than marketable securities, could be offset in full against ordinary income. Losses on marketable securities might be offset against gains plus other income to the extent of \$5,000-8,000 a year.

Some argue that there should be a basis adjustment, where property has been held a long period of time, to reflect the increase in price caused by inflation. In practice, fast depreciation probably allows for this in most cases. Also, there are other areas, apart of capital gains, where the inflation problem is at least as severe. For example, the effect of inflation on a savings bank account can be severe. In this case the interest income must be reported for tax purposes, even though it is no greater than the inflation rate. Also to the extent of any borrowing on the property, the cost of the property is paid off in the old dollar value. In addition, to make a basis adjustment here would destroy much of the simplification involved in taxing the capital gains as ordinary income.

As a result it is suggested that no basis adjustment be permitted but that longer term averaging be expanded as a way of dealing with the problem where capital gains represent a large part of the income.

The revenue increases suggested up to this point represent about \$14.5 billion in revenue which can be used to offset the rate reductions described next.

### III. Rate Bracket Reduction

It is proposed that there be substituted for the existing rate structure, which ranges from 14 percent to 70 percent, a new schedule with rates ranging from 13 percent to 50 percent. This also assumes that the 50 percent maximum tax on earned income is eliminated and the minimum tax. However, it is proposed that limitations be provided on preference items, to the effect that they cannot reduce what is otherwise taxable income by more than 50 percent. The rate reductions provided here would cost \$22.9 billion.

The small reduction at the bottom of the rate bracket is because the conversion of the exemption to a tax credit results in a substantial decrease for those in the bottom brackets.

These rate reductions should be a major attraction of the tax reform package. They also are essential to several different aspects of it. They make it possible--

- (1) to reduce itemized deductions;
- (2) to tax capital gains as ordinary income; and



(3) to deal with the double tax elimination proposal without any special rule on retained earnings, since the 50 percent top individual rate then approximates the corporate tax rate.

The rate reduction is not as large as it appears in the upper brackets because--

(1) capital gains are concentrated in these brackets and these are to be taxed as ordinary income;

(2) part of the rate reduction in the bottom brackets is given in the form of converting the exemption into the tax credit; and

(3) earned income already is taxed at a rate of 50 percent. Therefore, it is only investment income where the rate is being reduced appreciably (the same income which gives rise to the heavier tax on capital gains).

#### IV. Capital Formation

Capital formation is assisted by the reduction in tax rates for individuals (previously referred to) and through eliminating double taxation on corporate income.

It is suggested that we remove double taxation for dividends but not for retained earnings. However, bringing the top individual tax rate down to 50 percent means that, generally speaking, there is no net advantage in retaining earnings, except in the case of small businesses.

Chart 12 illustrates the double tax relief method which appears most practical--the "dividend gross up" method.

The chart illustrates this method with an example involving \$100 of corporate income and \$48 of corporate tax. This leaves \$52 of earnings after tax. It is, assumed that half of this, or \$26, is paid out as a dividend. The chart shows the tax treatment provided under present law and under the gross up method.

Under present law the shareholder includes the \$26 in income and if he is in the 40 percent rate bracket pays \$10.40 in additional tax. This leaves him \$15.60 of the dividend.



Under the proposal, the shareholder includes \$50 in income--\$26 of dividends and \$24 of tax paid on the dividends. Given a 40 percent rate bracket--although likely to be lower under the proposal--the shareholder's tax on this \$50 would be \$20. However, he would claim a credit for the \$24 of tax paid by the corporation. Four dollars of this would offset tax on other income and he would have additional tax to pay on the \$26 dividends. This means he would have \$30 additional after tax, as contrasted to \$15.60 under present law.

This would cost about \$9.9 billion in revenue. A series of other possible changes having their primary effect on business could increase revenues by at least \$5 billion, reducing the net business cost of this proposal to about \$4.5 billion.

This--

1. provides relief at the shareholder level, which should be more popular than giving the corporations a reduction;

2. costs less than providing relief from double taxation at the corporate level (It would cost about \$5 billion more at the corporate level since no corporate tax would be collected from shareholders who are tax-exempt organizations--including pension funds); and

3. has less the effect of a tax on undistributed proceeds than would a dividend reduction plan.

As to its effect on capital formation, double taxation relief would--

1. Probably provide somewhat less of an inducement for investment than an investment credit or more accelerated depreciation (but Congress has shown its reluctance lately in the stimulation package to provide disproportionate relief for capital intensive industries);

2. Any double taxation relief tends to encourage distributions--since this minimizes the tax burden. However--

- (a) equity values should rise appreciably, enabling firms to float stock issues at a lesser cost than previously;

(b) companies could expand their present dividend reinvestment plans as a source of new capital; and

(c) some corporations may reduce their dividends--in this way increasing cash flow--because the shareholder is better off, since the credit he receives for all practical purposes is the equivalent of an additional dividend.

3. Removal of the double tax burden should remove the distortion in favor of debt capital. This helps firms in weathering bad times and also encourages them to undertake riskier ventures;

4. Double tax relief removes the double tax burden in the case of all enterprises. Since it provides relief across the board its distributive effect should be similar to that of a corporate rate reduction.

#### V. Taxation of Foreign Income

It is suggested that three problems be dealt with in connection with foreign income:

1. Domestic International Sales Corporations (DISCs),
2. The tax treatment of Americans living abroad, and
3. The taxation of foreign shipping income.

DISC.--American exporters can defer U. S. taxes by allocating income to a DISC. Its income and assets must be derived primarily from an export business. Last year Congress limited DISC deferral to exports over 67 percent of average exports in a 4-year base period.

We question whether DISC treatment has any appreciable effect on increasing foreign sales. A recent Treasury study suggests the increase may be less than the revenue loss involved. Also, DISC exports may replace nonDISC exports. In addition, the value of the dollar may adjust foreign exchange markets to eliminate most of the growth in exports and may, in fact, stimulate the growth in imports.

It is suggested that DISC treatment be repealed for all future income. There is \$9.3 billion of deferred income outstanding now. It is suggested that a device be adopted which will have the effect of requiring this deferred income to be brought back into the tax base over a 10-year period.

The immediate effect of repealing DISC would be to raise revenues by about \$1.2 billion. This revenue pickup would grow in subsequent years.

Individuals.--Presently, U. S. citizens employed abroad can exclude from their income up to \$15,000 a year of income earned abroad. Various tax-free allowances are available to U. S. employees overseas instead of this exclusion.

We believe a more equitable system would substitute for the exclusion relief for housing costs in excess of typical U. S. costs and a limited amount of educational expenses. The relief could be in the form of a 20-percent tax credit against the U. S. tax on foreign income for--

1. housing costs over 20 percent of compensation, but not more than the housing allowance published by the State Department, plus
2. tuition and travel expenses in sending children to private schools abroad or public schools in the U.S., but not more than \$2,000 per child per year.

The credit would also apply to government employees.

This does not save revenue but is believed to be a more equitable way of dealing with the problems of U.S. citizens working abroad.

Shipping.--Foreign shipping income is exempt from U.S. tax if the foreign country exempts U. S. ships from income tax. Most countries do provide this exemption. This is especially important in tax-haven countries like Panama or Liberia.

To deal with this, the exemption could be limited to those predominantly engaged in the commerce of their own countries and by treating half of the income in voyages to and from the United States as arising in the United States and therefore subject to its tax.

These changes would not override tax treaties.

VI. Other Possible Business Related-Changes

Taking into account the revenue obtained from the repeal of the DISC provision, about \$5.4 billion of the \$9.9 billion revenue loss resulting from removing the double tax on corporate income could be recouped by:

- (1) Repeal of the bad debt allowance for commercial banks (about \$200 million),
- (2) Reduction by one-half of the special bad debt deductions of mutual savings banks and savings and loan associations (\$250 million),
- (3) Phasing down the percentage depletion in the case of other than the oil and gas industry by 50 percent over a 5-year period (\$350 million),
- (4) Providing withholding on bank account interest at a 20-percent rate (\$1.4 billion with an initial impact of about \$1.8 billion), and
- (5) Increasing the general corporate rate from 48 percent to 50 percent but keeping the present rate of tax as small business (about \$2 billion).

Repeal of the excess bad debt deduction for commercial banks merely speeds up the repeal of a provision which Congress decided to phase out in the Tax Reform Act of 1969. Commercial banks are allowed their average bad debt experience in the past 5 years in any event and have a special 10 year net operating loss carryback.

In a similar manner, Congress in 1969 began to phase down an excess bad debt deduction available for mutual savings banks and savings and loan associations from a special 60 percent deduction to a 40 percent deduction in 1979. It is suggested here that this special deduction be further phased down to 20 percent over a 5-year period beginning in 1978.

In 1975, Congress began phasing down the excess of percentage depletion over cost depletion in the case of oil and gas. Eventually these rates will be limited to a 15 percent depletion rate available on only the first 1,000

barrels of oil produced per day (excluding major oil and gas companies in all cases). It is suggested that the rates on other substances eligible for percentage depletion be reduced by one-half over a 5-year period. This is consistent with removing special incentives to consume increasingly scarce natural resources.

In effect, dividend income would be subject to withholding as a result of the double tax relief suggested previously. It would be desirable to extend withholding also to bank account interest. There is a significant amount of tax evasion in the case of this interest at the present time.

When an individual was not subject to tax in the prior year and has no reason to believe he will be in the current year, he could file an exemption certificate and have the withholding not apply. Also, the Federal Government by using tax and loan accounts in savings and loan associations and mutual savings banks could keep U.S. Government accounts in these banks and keep the deposit for a period of time from moving outside of these institutions. In addition, a low interest rate would be paid in these cases.

#### VII. Tax Treatment of Married and Single Persons

The changes recently made in the standard deduction and the other proposals made at this time substantially reduce the marriage penalty:

(1) Under prior law the marriage penalty ranged from \$1,300 to \$2,000. Under the bill just passed by Congress the penalty is reduced to a flat \$1,200.

(2) The proposed reduction in rates from 14 percent to 70 percent down to a range of 13 percent to 50 percent reduces the marriage penalty further.

(3) The proposed substitution of the \$200 (or \$215-240 credit with the energy proposals) per person credit as a substitute for the exemption and optional credit of present law significantly reduced the marriage penalty.

To further reduce the marriage penalty a limited tax credit could be provided based on the earnings of the lesser-earning spouse. A 10-percent credit on the first \$6,000 of earnings of such a spouse would provide a credit varying in size from zero up to \$600. This would cost about \$1.7 billion a year.

This change would almost eliminate the marriage penalty (reduce it to less than \$100 for incomes of \$30,000 or less) where incomes are split 70 percent-30 percent between the spouse--the usual case. Even where the income is split 50 percent-50 percent the penalty under present law is more than cut in half.

#### VIII. Taxable State or Local Government Bond Options

It is suggested that states and local governments be given the option to issue taxable bonds. When they do, the Federal government would agree to automatically pay from 35 percent to 40 percent of the interest costs on these taxable bonds.

States and municipalities would be aided because the Federal government subsidy would lower their interest costs whether or not they issue taxable bonds. The lower volume of tax-exempt bonds also would decrease the tax advantage of those purchasing these bonds. This would reduce their tax shelter effect.

This does not result in a revenue increase but decreases a major tax shelter under present law.

#### IX. Overall Effect

Table 2 shows the distribution effect of the tax reform program presented by expanded income class. Chart 11 shows effective rates under the program.

Table 2 shows the percentage distribution of the 1976 law burden, the proposals except for the business taxes, and the proposals taking into account the business proposals. This table indicates that the proportion of the burden is slightly increased for all of the higher income categories starting with the \$15,000-20,000 category. The shift, however, in all cases is slight for those with incomes of \$15,000 or more except for the income category of \$20,000-\$30,000 where the amount of income is large. Below \$15,000 the decrease tends to be larger, being a 1.0 percent shift below \$5,000 and 1.8 percentage points in the \$5,000-10,000 range and 0.9 percentage points in the category of \$10,000-\$15,000. This demonstrates that the changes in this tax reform program are slightly progressive. Despite any of the changes in income distribution there are reductions in all of the income classes.

Chart 13 shows the effective rates under the tax reform proposal. The rates range from a negative percentage in the less than \$5,000 category to an effective rate of slightly over 31 percent in the over \$200,000 category.

Table 3 summarizes the revenue effect of the tax reform program in terms of a full year of effect, based on 1976 income levels. The revenue loss on this basis is about \$14.7 billion.

Table 4 shows current budget projections of GNP, income tax receipts, and other tax receipts. Assuming the economy is not stimulated by a tax reduction, this table shows GNP going from \$2,037 billion in fiscal 1978 to \$2,948 billion in 1982. Receipts on this basis might go from \$396 billion in 1978 to about \$637 billion in 1982. The revenue effect the tax reform program outlined here is estimated to result in a revenue loss of about \$14.7 billion at 1976 levels of income. With higher income levels expected for the future this loss would be expected to expand to about \$24 billion in 1982 in the absence of any stimulative effect. However, this revenue loss will not grow because it is offset by an increase in revenues resulting from the stimulative effect of the tax reduction. As a result the net cost of the program is estimated at \$5.6 billion in the first year and between \$12 and \$12.8 billion in each of the other years. The stimulative effect on the economy is expected to increase GNP by about \$6 billion in 1978 and further increase it by \$41 billion in 1982.

W. Michael Blumenthal





THE SECRETARY OF THE TREASURY  
WASHINGTON 20220

MEMORANDUM FOR THE PRESIDENT

Subject: Possible Tax Reform Program

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DISC.--American exporters can defer U. S. taxes by allocating income to a DISC. Its income and assets must be derived primarily from an export business. Last year Congress limited DISC deferral to exports over 67 percent of average exports in a 4-year base period.

We question whether DISC treatment has any appreciable effect on increasing foreign sales. A recent Treasury study suggests the increase may be less than the revenue loss involved. Also, DISC exports may replace nonDISC exports. In addition, the value of the dollar may adjust foreign exchange markets to eliminate most of the growth in exports and may, in fact, stimulate the growth in imports.



It is suggested that DISC treatment be repealed for all future income. There is \$9.3 billion of deferred income outstanding now. It is suggested that a device be adopted which will have the effect of requiring this deferred income to be brought back into the tax base over a 10-year period.

The immediate effect of repealing DISC would be to raise revenues by about \$1.2 billion. This revenue pickup would grow in subsequent years.

Individuals.--Presently, U. S. citizens employed abroad can exclude from their income up to \$15,000 a year of income earned abroad. Various tax-free allowances are available to U. S. employees overseas instead of this exclusion.

We believe a more equitable system would substitute for the exclusion relief for housing costs in excess of typical U. S. costs and a limited amount of educational expenses. The relief could be in the form of a 20-percent tax credit against the U. S. tax on foreign income for--

1. housing costs over 20 percent of compensation, but not more than the housing allowance published by the State Department, plus

2. tuition and travel expenses in sending children to private schools abroad or public schools in the U.S., but not more than \$2,000 per child per year.

The credit would also apply to government employees.

This does not save revenue but is believed to be a more equitable way of dealing with the problems of U.S. citizens working abroad.

Shipping.--Foreign shipping income is exempt from U.S. tax if the foreign country exempts U. S. ships from income tax. Most countries do provide this exemption. This is especially important in tax-haven countries like Panama or Liberia.

To deal with this, the exemption could be limited to those predominantly engaged in the commerce of their own countries and by treating half of the income in voyages to and from the United States as arising in the United States and therefore subject to its tax.

These changes would not override tax treaties.

VI. Other Possible Business Related-Changes

Taking into account the revenue obtained from the repeal of the DISC provision, about \$5.4 billion of the \$9.9 billion revenue loss resulting from removing the double tax on corporate income could be recouped by:

- (1) Repeal of the bad debt allowance for commercial banks (about \$200 million),
- (2) Reduction by one-half of the special bad debt deductions of mutual savings banks and savings and loan associations (\$250 million),
- (3) Phasing down the percentage depletion in the case of other than the oil and gas industry by 50 percent over a 5-year period (\$350 million),
- (4) Providing withholding on bank account interest at a 20-percent rate (\$1.4 billion with an initial impact of about \$1.8 billion), and
- (5) Increasing the general corporate rate from 48 percent to 50 percent but keeping the present rate of tax as small business (about \$2 billion).

Repeal of the excess bad debt deduction for commercial banks merely speeds up the repeal of a provision which Congress decided to phase out in the Tax Reform Act of 1969. Commercial banks are allowed their average bad debt experience in the past 5 years in any event and have a special 10 year net operating loss carryback.

In a similar manner, Congress in 1969 began to phase down an excess bad debt deduction available for mutual savings banks and savings and loan associations from a special 60 percent deduction to a 40 percent deduction in 1979. It is suggested here that this special deduction be further phased down to 20 percent over a 5-year period beginning in 1978.

In 1975, Congress began phasing down the excess of percentage depletion over cost depletion in the case of oil and gas. Eventually these rates will be limited to a 15 percent depletion rate available on only the first 1,000

barrels of oil produced per day (excluding major oil and gas companies in all cases). It is suggested that the rates on other substances eligible for percentage depletion be reduced by one-half over a 5-year period. This is consistent with removing special incentives to consume increasingly scarce natural resources.

In effect, dividend income would be subject to withholding as a result of the double tax relief suggested previously. It would be desirable to extend withholding also to bank account interest. There is a significant amount of tax evasion in the case of this interest at the present time.

When an individual was not subject to tax in the prior year and has no reason to believe he will be in the current year, he could file an exemption certificate and have the withholding not apply. Also, the Federal Government by using tax and loan accounts in savings and loan associations and mutual savings banks could keep U.S. Government accounts in these banks and keep the deposit for a period of time from moving outside of these institutions. In addition, a low interest rate would be paid in these cases.

#### VII. Tax Treatment of Married and Single Persons

The changes recently made in the standard deduction and the other proposals made at this time substantially reduce the marriage penalty:

(1) Under prior law the marriage penalty ranged from \$1,300 to \$2,000. Under the bill just passed by Congress the penalty is reduced to a flat \$1,200.

(2) The proposed reduction in rates from 14 percent to 70 percent down to a range of 13 percent to 50 percent reduces the marriage penalty further.

(3) The proposed substitution of the \$200 (or \$215-240 credit with the energy proposals) per person credit as a substitute for the exemption and optional credit of present law significantly reduced the marriage penalty.

To further reduce the marriage penalty a limited tax credit could be provided based on the earnings of the lesser-earning spouse. A 10-percent credit on the first \$6,000 of earnings of such a spouse would provide a credit varying in size from zero up to \$600. This would cost about \$1.7 billion a year.

This change would almost eliminate the marriage penalty (reduce it to less than \$100 for incomes of \$30,000 or less) where incomes are split 70 percent-30 percent between the spouse--the usual case. Even where the income is split 50 percent-50 percent the penalty under present law is more than cut in half.

#### VIII. Taxable State or Local Government Bond Options

It is suggested that states and local governments be given the option to issue taxable bonds. When they do, the Federal government would agree to automatically pay from 35 percent to 40 percent of the interest costs on these taxable bonds.

States and municipalities would be aided because the Federal government subsidy would lower their interest costs whether or not they issue taxable bonds. The lower volume of tax-exempt bonds also would decrease the tax advantage of those purchasing these bonds. This would reduce their tax shelter effect.

This does not result in a revenue increase but decreases a major tax shelter under present law.

#### IX. Overall Effect

Table 2 shows the distribution effect of the tax reform program presented by expanded income class. Chart 11 shows effective rates under the program.

Table 2 shows the percentage distribution of the 1976 law burden, the proposals except for the business taxes, and the proposals taking into account the business proposals. This table indicates that the proportion of the burden is slightly increased for all of the higher income categories starting with the \$15,000-20,000 category. The shift, however, in all cases is slight for those with incomes of \$15,000 or more except for the income category of \$20,000-\$30,000 where the amount of income is large. Below \$15,000 the decrease tends to be larger, being a 1.0 percent shift below \$5,000 and 1.8 percentage points in the \$5,000-10,000 range and 0.9 percentage points in the category of \$10,000-\$15,000. This demonstrates that the changes in this tax reform program are slightly progressive. Despite any of the changes in income distribution there are reductions in all of the income classes.

Chart 13 shows the effective rates under the tax reform proposal. The rates range from a negative percentage in the less than \$5,000 category to an effective rate of slightly over 31 percent in the over \$200,000 category.

Table 3 summarizes the revenue effect of the tax reform program in terms of a full year of effect, based on 1976 income levels. The revenue loss on this basis is about \$14.7 billion.

Table 4 shows current budget projections of GNP, income tax receipts, and other tax receipts. Assuming the economy is not stimulated by a tax reduction, this table shows GNP going from \$2,037 billion in fiscal 1978 to \$2,948 billion in 1982. Receipts on this basis might go from \$396 billion in 1978 to about \$637 billion in 1982. The revenue effect the tax reform program outlined here is estimated to result in a revenue loss of about \$14.7 billion at 1976 levels of income. With higher income levels expected for the future this loss would be expected to expand to about \$24 billion in 1982 in the absence of any stimulative effect. However, this revenue loss will not grow because it is offset by an increase in revenues resulting from the stimulative effect of the tax reduction. As a result the net cost of the program is estimated at \$5.6 billion in the first year and between \$12 and \$12.8 billion in each of the other years. The stimulative effect on the economy is expected to increase GNP by about \$6 billion in 1978 and further increase it by \$41 billion in 1982.

W. Michael Blumenthal

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THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Peter Bourne  
Bob Lipshutz

The attached was returned in the  
President's outbox and is forwarded  
to you for your information and  
appropriate action.

Rick Hutcheson

Re: Decision on Domestic Cultivation  
of Papaver Bracteatum

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

May 12, 1977

MEMORANDUM TO THE PRESIDENT

FROM: Peter Bourne *P.B.*

SUBJECT: Decision on Domestic Cultivation of  
Papaver Bracteatum.

We have proceeded through all steps as outlined in my memo of January 29, which is attached.

In summary the four cabinet members from whom we solicited formal comments responded as follows:

Bergland - Opposed  
Califano - Opposed  
Vance - Strongly opposed  
Bell - Favored, but with reservations.

Subsequently, the Drug Enforcement Administration held public hearings before an Administrative Law Judge. Although the judge recommended that domestic cultivation be permitted, feeling that fears of the international implications were not sufficient to offset the benefits of domestic production of the plant, the Justice Department now accepts that there are overriding issues, not merely international, but particularly the strong and unexpected opposition of H.E.W., which is responsible for the authorization and approval of pharmaceutical drugs and medicines. The Justice Department now, therefore, also opposes domestic cultivation for commercial purposes.

In light of what is now uniform opposition to domestic cultivation, I recommend that we support that position. If you agree we will instruct the Justice Department to issue regulations in the Federal Register prohibiting commercial domestic cultivation and permitting only the continued restricted cultivation for research and developmental purposes.

We would see that we obtained credit for our decision from those countries, especially Turkey and Canada, who strongly opposed domestic cultivation.

Approve ✓ Disapprove \_\_\_\_\_

c.c. Zbigniew Brzezinski  
Jack Watson

*J*

Attachment

**Electrostatic Copy Made  
for Preservation Purposes**



THE WHITE HOUSE  
WASHINGTON

Date: May 13, 1977

MEMORANDUM

FOR ACTION:

Stu Eizenstat  
Bob Lipshutz *concur*  
Jack Watson *76*  
Zbigniew Brzezinski-*attached*

FOR INFORMATION:

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Peter Bourne memo 5/12 re Decision on Domestic  
Cultivation of Papaver Bracteatum.

YOUR RESPONSE MUST BE DELIVERED  
TO THE STAFF SECRETARY BY:

TIME: 11:00 A.M.

DAY: Monday

DATE: May 16, 1977

ACTION REQUESTED:

☒ Your comments

Other:

STAFF RESPONSE:

☐ I concur.

☐ No comment.

Please note other comments below:

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

5/19

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Approve \_\_\_\_\_ Disapprove \_\_\_\_\_

c.c. Zbigniew Brzezinski  
Jack Watson

Attachment

THE WHITE HOUSE

WASHINGTON

January 29, 1977

MEMORANDUM TO: The President

FROM: Peter Bourne P.B.

Attached is the memo you asked me to prepare on  
Papaver bracteatum for circulation to Secretaries  
Bell, Bergland, Califano and Vance.

PGB:mp

MEMORANDUM FOR THE PRESIDENT

FROM: Peter G. Bourne

SUBJECT: PROPOSED DOMESTIC CULTIVATION OF PAPAVER BRACTEATUM

As you requested, this memorandum provides additional background concerning the proposal to permit limited commercial cultivation of Papaver bracteatum in the United States.

Background

Historically, the principal raw material for codeine - a drug widely used for mid-level pain relief and as a cough suppressant - has come from opium poppy (Papaver somniferum). Since this plant is also the raw material for heroin, United States and international policy has always been to keep worldwide supply and demand in close balance, lest some excess legitimate production find its way into illicit channels. Thus, there is not much slack in the system, and when the growth in worldwide demand unexpectedly quickened at the same time that a number of major producing countries had crop reversals, a tight supply situation developed in 1973.

We were able to avert an actual shortage in the United States by first releasing part of our strategic stockpile in December, 1973\* and then by authorizing the importation of alternative derivatives of the opium poppy in December, 1974\*\*. These steps were successful, and stocks in both the United States and worldwide have begun to return to levels more appropriate to providing adequate safety margins. But, as could be expected in a period of tight supplies, prices rose sharply; the price for codeine more than doubling between 1974 and 1976, largely due to raw material price increases.

During the time that these emergency steps were being taken to avert an actual shortage, efforts intensified to reduce the supply vulnerability to a single crop traditionally grown in relatively primitive areas (Turkey, India). One promising area of research was with another type of poppy, Papaver bracteatum; a potential substitute raw material which appeared to have a significantly lower potential for abuse (heroin cannot be made from it) and which promised lower agriculture costs (Yield per acre is estimated at several times that of the traditional opium poppy).

- 
- \* Recommended by President Nixon and approved by Congress
  - \*\* Done administratively in Justice, with President Ford informed of the action.

The Bracteatum Proposal

Requests to authorize the domestic cultivation and processing of bracteatum have become increasingly urgent (1) as agricultural and processing experiments have demonstrated its cost advantage over world prices, and (2) as questions about the potential abusability of bracteatum and its derivatives have been answered negatively. The rationale for these requests has been that bracteatum would offer a cheaper and more dependable raw material supply, and that even limited domestic production would help bring world prices for traditional raw material supplies back to more normal levels.

In response to these requests, the Administrator of the Drug Enforcement Administration (Justice) published a notice in the Federal Register on November 19, 1976 which proposed extremely tight regulations for cultivation of sufficient bracteatum to meet 5 percent of United States needs in 1977, growing to 20 percent in 1980. Papaver bracteatum has been grown experimentally on federal reservations in Colorado and Montana. Two drug companies with an interest in commercial cultivation, Mallinckrodt and the Endo Division of DuPont, have grown small quantities in several other states. The final sites for possible commercial cultivation have not yet been selected.

The Federal Register notification invited all interested parties to comment or object to the proposal by December 21, later extended to January 28, 1977. A total of 48 formal responses were received, divided as follows:

- ..43 for implementing the proposal
  - Seven from prominent academics or researchers in the field of drug abuse;
  - Six from various medical associations, including the American Medical Association, the American Dental Association, the American Academy of Family Physicians, and the Pharmaceutical Manufacturers Association;
  - 25 Pharmaceutical manufacturers, including all of the major firms; and
  - Two members of Congress: Senator Helms and Congressman Walter Jones.
- ..Three against implementing the proposal
  - State Department: signed by Dr. Kissinger on January 20
  - The since-retired Secretary of the United Nations International Narcotic Control Board
  - Canadian Government: in a note "expressed concern" and "urged all due caution....in weighing the possible effect of the introduction of this new narcotic crop"

Because of the disparate responses, the Administrator of the Drug Enforcement Administration has scheduled public hearings before an administrative law judge for March 15, 16 and 17. These hearings were originally scheduled for January 27, but were postponed at my request so that your appointees would have time to formulate their own positions on the issue, and so a better assessment of reaction by foreign governments to an affirmative decision could be made at the meeting of the United Nations Commission on Narcotic Drugs to be held in Geneva in February.

#### The Arguments For and Against

The core of the argument for this limited domestic production is that it will: (1) be at least 25 percent and perhaps 50 percent cheaper than prevailing world prices; (2) will act as incentive for foreign producers to reduce the prices for their raw materials to levels more consistent with production costs; and (3) eliminate our total reliance on uncertain foreign supplies without reducing the absolute amount we import (because of the sliding scale on production, which is slightly lower than the rate of growth in demand). In addition, the argument has been raised that in the absence of a compelling reason to prohibit limited domestic production, the current policy represents unwarranted government interference in the market resulting in an unjustifiable cost burden to the consumer. Technically, the pharmaceutical companies have the legal right to proceed with domestic cultivation, but claim they are not doing so out of deference to their desire to act responsibly and in accord with overall federal narcotic policy.

The Department of State, particularly Ambassador Vance (the outgoing Senior Adviser to the Secretary for Narcotics Matters) has vigorously opposed domestic production, discussing the above arguments as relatively insignificant in comparison to the possible international consequences. These are: (1) that even this small amount of United States production will add to a potential oversupply which may be developing due to large increases in Turkish, French, and Australian production and more limited increases elsewhere; (2) that the "moral force" of the United States would be weakened in its efforts to convince countries less able to control production or to prohibit production; (3) that the Governments of Afghanistan, Pakistan and Thailand might seize the United States decision as an excuse to accede to local political pressure to merely "legalize" currently illegal, uncontrolled growth of opium poppies; and (4) that this limited phase-in of United States production is merely the opening gambit in an attempt by the United States pharmaceutical industry to take over a profitable industry from underdeveloped foreign nations.

My personal opinion is that the arguments on both sides, are usually overstated, and that the real impact of domestic growth on domestic prices and the international narcotic control system will be slight.

The economic impact on India and Turkey will be significantly ameliorated by the slow phase-in of domestic cultivation. At present, on balance, I support the proposed regulations as a very conservative response to legitimate concern by the medical community - one which can be modified or even reversed if developments warrant. However, before a final decision is made, I believe the following steps should be taken:

- (1) Obtain the opinions of those cabinet officers likely to be affected by the decision; Secretaries Bell, Bergland, Califano and Vance.
- (2) Proceed with the hearings already scheduled by the Justice Department for March 15, 16 and 17, to allow all parties with an interest in the decision to express their opinions in a public forum.
- (3) Seek to define more specifically the extent of the negative reaction by foreign governments to a decision to allow domestic cultivation. I have asked the members of the United States delegation to the meeting of the United Nations Commission on Narcotic Drugs scheduled to begin meeting in Geneva on February 7 to ascertain informally the intensity of feelings on this issue.

The final decision should be made before the end of March. If the decision is affirmative, then I believe a small delegation should visit each of the countries that would be affected to explain why the decision was made, and hopefully ameliorate the reaction.



FOR ACTION:

Stu Eizenstat ✓  
Bob Lipshutz  
Jack Watson  
Zbigniew Brzezinski

FOR INFORMATION:

XC *Camp*  
*300 Rubenstein*

977 MAY 13 PM 12 58

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Peter Bourne memo 5/12 re Decision on Domestic  
Cultivation of Papaver Bracteatum.

YOUR RESPONSE MUST BE DELIVERED  
TO THE STAFF SECRETARY BY:

TIME: 11:00 A.M.

DAY: Monday

DATE: May 16, 1977

ACTION REQUESTED:

☒ Your comments

Other:

STAFF RESPONSE:

☐ I concur.

Please note other comments below:

☒ No comment.

*Stu Eizenstat*

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Date: May 13, 1977

MEMORANDUM

FOR ACTION:

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## NATIONAL SECURITY COUNCIL

May 14, 1977

MEMORANDUM FOR: RICK HUTCHESON

FROM: MICHAEL HORNBLOW *lh*

SUBJECT: Decision on Domestic Cultivation of  
Papaver Bracteatum

The NSC Staff concurs in Peter Bourne's memo and his recommendation. There is no net advantage and a great deal of disadvantage in permitting the cultivation of the Bracteatum Poppy in the U.S.

THE WHITE HOUSE  
WASHINGTON

Mr. President:

Lipshutz and Brzezinski  
concur. Watson and  
Eizenstat have no comment.

Rick

THE WHITE HOUSE  
WASHINGTON

January 29, 1977

MEMORANDUM TO: The President

FROM: Peter Bourne *P.B.*

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~~SECRET~~

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Bob Lipshutz -

The attached was returned in  
the President's outbox. It is  
forwarded to you for appropriate  
handling.

Rick Hutcheson

Re: Helms/IT T Investigation  
Request for DOJ for Information

DECLASSIFIED  
E.O. 12958, SEC. 3.4(a)  
WHITE HOUSE GUIDELINES, E.O. 24, 1983  
BY *Jay* DATE *9/29/89*

THE WHITE HOUSE  
WASHINGTON

May 17, 1977

THE PRESIDENT HAS SEEN.

MEMORANDUM FOR THE PRESIDENT

FROM: ROBERT LIPSHUTZ *RL*  
MARGARET MCKENNA *MM*

SUBJECT: Helms/ITT Investigation -  
Request by DOJ for Information

The Justice Department has requested declassification of certain documents they believe necessary to proceed in the Helms/ITT investigation. The NSC and CIA have reviewed the documents and, with the exception of some deletions concerning protection of sources and methods, and contact with foreign leaders, have declassified the documents. The majority of the documents and those which apparently caused the most foot dragging on this decision in the Ford Administration, are minutes of several 40 Committee meetings. These meetings concern the decision making process and advice to the President. You could, if you wish, exert Executive privilege over these documents and we would in all likelihood be successful in that decision. We do not recommend that you exert this privilege.

In forwarding the documents to the Justice Department we will attach a statement making it clear that this is an exceptional decision on our part, both in declassifying the majority of these documents and in not claiming any privilege so as to avoid any precedent which would erode our ability to protect the Presidential decision making process from unnecessary disclosures in the future.

OPTIONS

1. Forward the documents as  
declassified to the  
Justice Department with  
no claim of Executive Privilege  
(Recommended) ☒
2. I wish to review the documents. ☐

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Bert Lance  
Stu Eizenstat  
Bob Lipshutz  
Jack Watson

The attached was returned in the  
President's outbox and is forwarded  
to you for your information and  
appropriate action.

Rick Hutcheson

Re: FNMA Directors

THE WHITE HOUSE  
WASHINGTON

Mr. President:

Eizenstat/Lipshutz comments  
are attached. Watson  
concurs with their comments.

Rick

THE WHITE HOUSE  
WASHINGTON

*copy only  
lance memo*

ACTION	FYI
	MONDALE
	COSTANZA
<input checked="" type="checkbox"/>	EIZENSTAT
	JORDAN
<input checked="" type="checkbox"/>	LIPSHUTZ
	MOORE
	POWELL
<input checked="" type="checkbox"/>	WATSON

<input type="checkbox"/>	ENROLLED BILL
<input type="checkbox"/>	AGENCY REPORT
<input type="checkbox"/>	CAB DECISION
<input type="checkbox"/>	EXECUTIVE ORDER
	Comments due to Carp/Huron within 48 hours; due to Staff Secretary next day

<input type="checkbox"/>	FOR STAFFING
<input type="checkbox"/>	FOR INFORMATION
<input checked="" type="checkbox"/>	FROM PRESIDENT'S OUTBOX
<input type="checkbox"/>	LOG IN/TO PRESIDENT TODAY
<input type="checkbox"/>	IMMEDIATE TURNAROUND

<input type="checkbox"/>	ARAGON
<input type="checkbox"/>	BOURNE
<input type="checkbox"/>	BRZEZINSKI
<input type="checkbox"/>	BUTLER
<input type="checkbox"/>	CARP
<input type="checkbox"/>	H. CARTER
<input type="checkbox"/>	CLOUGH
<input type="checkbox"/>	FALLOWS
<input type="checkbox"/>	FIRST LADY
<input type="checkbox"/>	GAMMILL
<input type="checkbox"/>	HARDEN
<input type="checkbox"/>	HOYT
<input type="checkbox"/>	HUTCHESON
<input type="checkbox"/>	JAGODA
<input type="checkbox"/>	KING

<input type="checkbox"/>	KRAFT
<input checked="" type="checkbox"/>	LANCE
<input type="checkbox"/>	LINDER
<input type="checkbox"/>	MITCHELL
<input type="checkbox"/>	POSTON
<input type="checkbox"/>	PRESS
<input type="checkbox"/>	B. RAINWATER
<input type="checkbox"/>	SCHLESINGER
<input type="checkbox"/>	SCHNEIDERS
<input type="checkbox"/>	SCHULTZE
<input type="checkbox"/>	SIEGEL
<input type="checkbox"/>	SMITH
<input type="checkbox"/>	STRAUSS
<input type="checkbox"/>	WELLS
<input type="checkbox"/>	VOORDE



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

THE PRESIDENT HAS SEEN.

MAY 13 1977

MEMORANDUM FOR: THE PRESIDENT  
FROM: Bert Lance *BR-*  
SUBJECT: FNMA Directors

Senator Proxmire has introduced a bill that would expand the Board of Directors of the Federal National Mortgage Association (FNMA) from 15 to 19 and the number of Directors appointed by the President from five to nine. Secretary Harris is requesting clearance of an Administration position in favor of the bill.

Issue

Should the Administration endorse legislation increasing the number of FNMA Directors?

Background

FNMA is a federally chartered, but privately owned, corporation whose primary purpose is to maintain a secondary market for mortgages. FNMA finances its activities by borrowing on the private credit market, selling stock, and charging fees for purchase commitments. In addition, FNMA has a \$2.25 billion line of credit with Treasury.

Federal ties to FNMA are maintained in three ways:

- . The President appoints five of the 15 members of the Board of Directors. The other ten are elected by stockholders.
- . Treasury must approve all FNMA debt issues to insure that they do not interfere with Treasury's cash management and borrowing responsibilities.
- . The Secretary of Housing and Urban Development audits FNMA, sets debt to equity ratios, and exercises "general regulatory power."

### Analysis

The Corporation's unique status -- privately owned, but federally chartered -- is at the heart of the issue, which pits the interests of FNMA stockholders against the Federal Government's interests in promoting certain national goals. FNMA has improved the liquidity of mortgages and facilitated the flow of mortgage credit from areas of surplus to areas of shortage. However, HUD and certain members of Congress maintain that FNMA has not given adequate support to Federal housing initiatives, or acted to restrain housing production during cyclical upswings.

The addition of four Presidentially appointed Directors would allow the Administration to exert greater influence over FNMA operations, in order to:

- . help smooth the mortgage credit cycle;
- . better support Federal initiatives in the inner-city;
- . hold down mortgage interest rates.

The major arguments against increasing the number of Presidentially appointed Directors are that:

- . existing Federal controls over FNMA probably are sufficient to influence its operations;
- . any move to make the Corporation more socially oriented would reduce FNMA's profit margin, and thereby --
  - jeopardize the stockholders' financial interest;
  - weaken private sector confidence in FNMA, resulting in less money available for housing.

### NOTE

You should be aware that FNMA opposes this Bill. If the legislation is enacted FNMA has indicated that it will challenge the Act's constitutionality on the basis that increasing public representation on the Board would constitute a taking of property without due process. As a memo you have received from Bob Lipshutz and Stu Eizenstat indicates this is a close question although HUD's preliminary review indicates that the Bill is constitutional. I make the recommendation below despite this qualification, but do agree with the Lipshutz-Eizenstat



position that we request an opinion from the Attorney General as to the Bill's constitutionality.

Recommendation

I recommend that you endorse an increase in the number of FNMA Directors.

Agree

Disagree

See me

☒ *to Atty Gen opinion*  
☐  
☐ *J*

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for Preservation Purposes**

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for Preservation Purposes**

THE WHITE HOUSE

WASHINGTON

May 4, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM:

BOB LIPSHUTZ *mm*  
STU EIZENSTAT *RL*  
MARGARET MCKENNA *MM*

SUBJECT: FNMA Directors

We concur with Bert Lance's recommendation that HUD be authorized to endorse the Proxmire bill, with this caveat:

FNMA violently opposes this bill. If legislation is enacted, FNMA will challenge its constitutionality in court. They have already received an opinion from a major law firm concluding that increasing the public representation would constitute a taking of property without due process.

The Constitution protects individuals, including corporations, against Federal action divesting vested rights. The issue is whether FNMA or its shareholders have a vested right in the present structure of FNMA's Board. Based on a brief review, we believe this is a potentially close constitutional question; it has not been seriously researched by the Administration, although a preliminary review by HUD suggests that the bill is constitutional.

In light of FNMA's intention to litigate, the Treasury Department has recommended that the Administration indicate to the Banking Committee that we support the bill, but that we have requested an opinion from the Attorney General as to its constitutionality. Unconditional Administration support would await a favorable ruling by the Attorney General.

We agree with Treasury's position. HUD and OMB regard the opinion as unnecessary and prefer an unconditional endorsement now.

We recommend seeking an opinion because:

- Enactment of this bill, which we recommend, will in itself adversely affect the value of FNMA securities.

Litigation challenging the constitutionality of the new board could further seriously destabilize the FNMA borrowing market. A favorable opinion by the Attorney General would increase investor confidence and stabilize the market; a stable market is necessary to overcome FNMA's resistance to a more socially responsive housing policy.

- The present Supreme Court is strongly protective of bondholders' rights--i.e., we could lose an appeal. At this time, the Administration is unable to evaluate knowledgeably our probability of success.

Note: Despite the legal uncertainties, we strongly recommend support of the bill. In our judgment, FNMA's market operations may have inflated mortgage rates and have not adequately stabilized the flow of housing credit.

OPTIONS:

- \_\_\_\_\_ Endorse bill but request opinion
- \_\_\_\_\_ Endorse bill unconditionally
- \_\_\_\_\_ Do not endorse bill

*My own  
to comment*

THE WHITE HOUSE  
WASHINGTON

Date: May 13, 1977

MEMORANDUM

FOR ACTION:

Jack Watson

FOR INFORMATION:

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Bob Lipshutz, Stu Eizenstat, and Margaret McKenna  
memo 5/4/77 re FNMA Directors.

YOUR RESPONSE MUST BE DELIVERED  
TO THE STAFF SECRETARY BY:

TIME: 2:00 P.M.

DAY: Monday

DATE: May 16, 1977

ACTION REQUESTED:

☒ Your comments

Other:

STAFF RESPONSE:

☐ I concur.

☐ No comment.

Please note other comments below:

*Bill -  
This goes in  
today*

*5/19*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

D 3: May 13, 1977

MEMORANDUM

## FOR ACTION:

Jack Watson

## FOR INFORMATION:

1977 MAY 13 PM 2 02

Bruce K  
B-  
Please give  
me comments  
ASAP  
JW

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: Bob Lipshutz, Stu Eizenstat, and Margaret McKenna  
memo 5/4/77 re FNMA Directors.YOUR RESPONSE MUST BE DELIVERED  
TO THE STAFF SECRETARY BY:

TIME: 2:00 P.M.

DAY: Monday

DATE: May 16, 1977



## ACTION REQUESTED:

☒ Your comments

Other:

## STAFF RESPONSE:

☐ I concur.☐ No comment.

Please note other comments below:

## PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

THE WHITE HOUSE  
WASHINGTON

MEMORANDUM TO: THE PRESIDENT

FROM: Jack Watson  
Jane Frank

*Jack*

May 18, 1977

RE: FNMA Directors

I concur with Bob, et al, that you should endorse the bill but request an opinion on its constitutionality from the Attorney General. FNMA's present policies with respect to crucial urban issues like red-lining, home mortgage financing, debt financing, etc., are likely to run counter to those of your Administration. Expansion of its Board--assuming it's constitutional--is likely to enable the corporation to be more responsive to the concerns of state and local governments.

The down side, of course, is the bad taste left by such initiatives as President Franklin Roosevelt's attempt to "pack" the Supreme Court. In this case, however, it is Senator Proxmire's initiative, and we are not dealing with the Judiciary Branch of government but with a corporation charged with carrying out government housing policy.

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Hamilton Jordan -

The attached was returned in the  
President's outbox and is forwarded  
to you for your information.

Rick Hutcheson

Re: *Note*  
~~Call~~ to Henry Owen

THE WHITE HOUSE  
WASHINGTON

ACTION  
FYI

MONDALE  
COSTANZA  
EIZENSTAT  
X JORDAN  
LIPSHUTZ  
MOORE  
POWELL  
WATSON

ENROLLED BILL  
AGENCY REPORT  
CAB DECISION  
EXECUTIVE ORDER  
Comments due to  
Carp/Huron within  
48 hours; due to  
Staff Secretary  
next day

FOR STAFFING  
FOR INFORMATION  
X FROM PRESIDENT'S OUTBOX  
LOG IN/TO PRESIDENT TODAY  
IMMEDIATE TURNAROUND

ARAGON  
BOURNE  
BRZEZINSKI  
BUTLER  
CARP  
H. CARTER  
CLOUGH  
FALLOWS  
FIRST LADY  
GAMMILL  
HARDEN  
HOYT  
HUTCHESON  
JAGODA  
KING

KRAFT  
LANCE  
LINDER  
MITCHELL  
POSTON  
PRESS  
B. RAINWATER  
SCHLESINGER  
SCHNEIDERS  
SCHULTZE  
SIEGEL  
SMITH  
STRAUSS  
WELLS  
VOORDE



THE WHITE HOUSE  
WASHINGTON

done  
J

Mr. President - THE PRESIDENT HAS SEEN.

If you have not already done so, I believe a congratulatory note to Henry Owen is in order.

He is leaving to go back to Brookings. From my perspective, his work on the preparation for the summit was superb.

H.J.

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THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Jack Watson -

For your information the attached  
was returned in the President's  
outbox without notations.

Rick Hutcheson

Re: Status Report

THE PRESIDENT HAS SEEN.

THE WHITE HOUSE

WASHINGTON

May 16, 1977

MEMORANDUM FOR: THE PRESIDENT

FROM: Jack Watson *Jack*

RE: STATUS REPORT

I. REVIEW OF FEDERAL REGIONAL COUNCILS AND TITLE V COMMISSIONS.

Three weeks ago, we distributed a set of questions and various proposals concerning the Federal Regional Councils to all Governors; all Cabinet members (through the Under Secretaries); all major Public Interest Groups (U. S. Conference of Mayors, National Governors Conference, National Association of Counties, etc.) and all ten FRC's. We have received responses from almost everyone. I have asked for 45 minutes on your schedule this Friday to report our findings and recommendations; put the FRC study in the context of our ongoing overall review of federal aid administration; and seek some directions as to our next steps.

As part of the federal regional presence evaluation, I have travelled to Seattle, Portland, and Boston within the past two weeks and have talked extensively with mayors, governors, county commissioners, councils of government, as well as federal region office staffs and the Chairpersons of the FRC's and Title V Commissions. My staff met with seven of the ten executive directors of the FRC's and the HEW regional intergovernmental staffs at their annual meeting in San Antonio. These direct contacts have been extraordinarily helpful and fully confirm your view that there is a pressing need for substantial remedial action.

It is important that we resolve the FRC issue as soon as possible, not only because the reforms are long overdue, but also because our regional people sorely need clarification of their roles and responsibilities. Moreover, your decision on this subject will also have a significant bearing on the Cabinet members' decisions concerning their departmental regional offices.

II. FEDERAL AID ADMINISTRATION REFORMS.

As a follow-up to your approval of the federal aid administration memorandum which Stu and I sent you last week, I have pulled together a small group of very experienced state and local civil servants to

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work full-time with Stu's staff, OMB and my staff to help us address cross-cutting federal aid problems where White House attention could make a difference. I shall outline our progress on this when we meet with you on Friday.

### III. INTERGOVERNMENTAL RELATIONS IN THE DEPARTMENTS.

As a follow-up on your February 25th memorandum to Cabinet Secretaries and agency heads regarding state and local input into departmental policy processes, and to your statements to the Governors at the Governors' Conference, we have taken the following steps:

- A. Reconvened the Under Secretaries Group primarily to review federal regional operations;
- B. Provided specific suggestions to the departments regarding implementation of your February 25th memorandum (see attached memorandum);
- C. Worked with the Secretaries to upgrade the role and position of intergovernmental relations staffs in the Departments in order to meet your objectives for state/local relations;
- D. Convened a meeting of all departmental intergovernmental personnel as a first step to activate a "network" of IGR people throughout the departments similar to the Congressional Relations group coordinated by Frank Moore. This group will meet regularly. (Although everyone recognizes the potential benefits of having such a network, one has never really existed before now. I am encouraged by the calibre and enthusiasm of the people who have been appointed by the Secretaries to handle intergovernmental responsibilities.)

### IV. DEPARTMENT AND STATE/LOCAL INVOLVEMENT IN ENERGY PLAN IMPLEMENTATION.

We have been working closely with Jim Schlesinger's staff to implement the following activities:

- A. A briefing on the energy plan for Under Secretaries and Assistant Secretaries in the departments (May 9, 1977). We will continue to convene and coordinate work sessions with individual departments to address special problem areas and concerns with the energy staff.
- B. A meeting between the executive directors and energy staffs of the major public interest groups and Jim Schlesinger's staff (May 11th). One of the results of that meeting was Jim's assignment of a staff person to work full-time with my staff to identify specific problem

spots and to solicit ideas from the state and local officials who will have a major role in implementing your energy objectives.

- C. We have distributed to the Cabinet a package of energy-related information which includes commonly-asked questions and answers; history and background on our overall energy situation; and speech material.
- D. We are asking the Cabinet Secretaries and other top departmental officials to let us know their travel schedules so that we can coordinate the filling of speech requests received by the Energy Office.
- E. With the help of three or four of the best available state and local energy experts, Jim's staff and mine are working on a document which will outline in detail what can be done by cities, counties and states to implement your energy objectives.

V. WELFARE REFORM.

Jim Parham has been working closely with HEW, Labor and Stu's staff on development of the next phase of the welfare plan, including consultation with the fifty governors, as you requested.

VI. MILITARY BASE CLOSINGS.

Charles Duncan and I are trying to develop a systematic approach to proposed base closings which would include a proper recognition and timely consideration of the economic, employment and related impacts of closings and realignments on local areas. I have asked OMB to work with us on the matter because they have just completed an analysis of the Office of Economic Adjustment.

VII. INTERAGENCY GROUP COORDINATION.

- A. Urban and Regional Policy Cluster.
- B. HIRE Program Steering Committee.
- C. Puerto Rico Economic Impact Analysis Group.
- D. Regulation Reform Group.
- E. CSA/White House/Utilities Task Force to resolve use of \$280-million emergency energy crisis intervention funds.
- F. Economic Policy Group.
- G. Undocumented Worker Committee.

Members of my staff are serving as staff, coordinators and/or members of all of the foregoing interagency groups.

It is interesting to note that virtually every activity in this memorandum reenforces the merit of your original concept of combining the Cabinet Secretary and IGR roles. As you suspected when you first talked to me about the job last November, there is a tremendous creative potential in the connection between the two for primarily two reasons:

- The convergence of the two responsibilities in one place makes it possible for the IGR function to be constantly and closely connected to the Cabinet (i.e. federal) policy-making process and, therefore, to be more than merely a "liaison" role as it has been in the past.
- For the same reason, the role of the Secretary to the Cabinet also has a constructive dimension that it has not had before.

Over the past three months, I've come to realize that effective inter-governmental relations and effective federal interagency coordination and management are two sides of the same coin. We've only begun to scratch the surface of a very large potential -- but we're making progress.

SUGGESTIONS FOR IMPLEMENTING THE PRESIDENT'S  
MEMORANDUM ON STATE/LOCAL CONSULTATION

1. Intergovernmental relations is not a discrete field. Much departmental policy making will have significant intergovernmental impact (not to mention actual service delivery by state and local governments) even though its principal focus is not intergovernmental. Therefore, you will need to be involved in department-wide policy processes in order to meet the objective of the President's February 25th memorandum.
2. You should operate on the presumption that all major department policy, organization, budget and regulations have intergovernmental significance unless proved otherwise.
3. To be meaningful, consultation must be:
  - Early in the process;
  - Based on adequate prior notice and information;
  - Involve federal policy makers who will share the current thinking of the department with state and local officials; and
  - Reflective of the actual thinking of competent state and local public officials as a supplement to the reaction of the national public interest groups.
4. For the President's objectives to be met, consultation must be built into the process of policy development. It cannot be an add-on after internal policy agreement is reached. This consultation need not require substantial delay.
5. It is the affirmative obligation of the Departments to reach out and to develop ways to facilitate state and local input. A passive willingness to receive comments is not enough.
6. Some ways to meet these conditions include:
  - Periodic publication of a calendar of the projects underway in the Department with IGR significance, so that others could track progress and express desire to participate;
  - More fully adhere to OMB Circulars A-85 and A-95;
  - Upgrade the Department's overall IGR operation, placing the IGR component within the "policy loop"; and
  - Using the Department field offices more effectively as a device for soliciting and receiving state and local input.
7. So that the President can benefit from this consultation process, Departmental submissions in areas covered by the February 25th memorandum should include a cover sheet describing the nature of the consultation, characterizing the comments received, and indicating what the disposition was on IGR issues.

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Stu Eizenstat -

The attached was returned in the  
President's outbox and is forwarded to  
you for your information.

Rick Hutcheson

Re: Speech by Charlie Schultze  
to New York Financial Writers  
Association



THE PRESIDENT HAS SEEN.

THE CHAIRMAN OF THE  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON

*Stu*  
*J*

May 18, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: Charlie Schultze <sup>CLS</sup>

SUBJECT: Speech

I am attaching the text of a speech that I will give this evening to the New York Financial Writers Association. In it, I have outlined the strategy that underlies our budgetary and economic plans. My objective is to make clear that balancing the budget is no fetish, but that there are sound economic and political arguments for proceeding in the manner that we have chosen.

I thought you might be particularly interested in pages 11 and 12, which summarize the points I make in the speech.

Attachment

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for Preservation Purposes**

EMBARGOED UNTIL PRESENTED  
May 18, 1977

EXECUTIVE OFFICE OF THE PRESIDENT  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON, D.C. 20506

REMARKS BY

CHARLES L. SCHULTZE, CHAIRMAN  
COUNCIL OF ECONOMIC ADVISERS

BEFORE THE

NEW YORK FINANCIAL WRITERS ASSOCIATION  
THE AMERICANA HOTEL

May 18, 1977

---

The first months of this Administration have seen a flurry of activity on the economic front. We have offered programs to stimulate the economy and to gain better control of inflation. We have outlined major overhauls of the social security and welfare systems and begun work on a thorough reform of the tax system. An energy program has been announced that will shape economic decisions for decades to come. In the next several weeks, the Administration will begin the long process of formulating the fiscal 1979 Federal budget, the first entirely "Carter" budget.



As complicated and varied as they are, our economic and budgetary proposals have not been made in isolation. We have developed our policies with a view to achieving a concrete set of objectives. Our longer-run objectives are the following:

-- To cut the rate of unemployment to 4-3/4 percent by 1981 through general economic stimulus and targeted jobs programs.

-- To achieve a reduction in the rate of inflation through specific government actions and through cooperation with business and labor to break out of the price-wage spiral.

-- To balance the Federal budget in a high employment economy by 1981.

-- To reduce somewhat the share of Federal spending in the gross national product.

To reach these objectives, our economy will need to grow between now and 1981 at an average rate of about 5-1/4 percent per year. Nearly 10 million new jobs will have to be created. We will have to make some hard choices to meet our social objectives while keeping total Federal spending within the boundaries we have specified. And we will have to be constantly alert to the threat of renewed inflationary pressures as our economy gets back to full employment. Attaining any one of these goals

alone perhaps would not be unduly difficult. Attaining all of them together will require careful management of our overall economic and budgetary policies.

I would like to outline for you today the relation between economic and budgetary objectives over the longer term, and discuss the Administration's strategy to achieve these goals.

It is natural that we set targets both for the economy and for the budget in years ahead, for there is an intimate interrelationship between the two.

The rate of economic growth clearly affects the size of the budget. A rapidly growing economy generates substantial increases in consumer spending and incomes, and in business investment and profits. As a result, Federal tax revenues tend to grow at a faster pace. Moreover, a fast-growing economy means more jobs are being created, reducing Federal outlays for unemployment insurance or for other income maintenance programs. Correspondingly, when economic growth slows, there is a drag on tax revenues and upward pressure on expenditures.

But Federal budgetary policies also affect the rate of economic growth. Tax reductions can stimulate consumer spending, and so raise output and incomes. Increased Federal expenditures -- if the money is used wisely --

will put people to work and stimulate growth in the private economy. Fiscal stimulants are appropriate and desirable when there is ample slack in the economy, but they will become inflationary if they are continued in a period of high employment and production.

Thus, our problem in constructing economic and budget policies is to keep these interrelationships in mind. If the private economy grows strongly enough in coming years, Federal revenues will be sufficient in 1981 to balance the budget at full employment. Indeed, with output and employment at high levels, and with the private economy growing strongly, balancing the Federal budget is not only feasible but necessary. A budget deficit in those circumstances would lead to overstimulation of the economy, an acceleration of inflation, and a sharp tightening of financial markets. Confidence of consumers and businesses would be undermined. In all probability, a major increase in inflation would ultimately lead to a recession. The chances are good that the American people can enjoy a long period of stable and sustained economic growth -- after a traumatic four years of double-digit inflation and severe recession. We cannot afford to wreck those chances by failure to plan now for the balanced budget that is appropriate in a fully employed economy.

On the other hand, should growth in the private economy begin to fade, Federal revenues will fall below our target track. Under those circumstances, tax increases or expenditure reductions designed to reach budget balance at lower levels of employment and income would only weaken the private economy still further. Indeed, if the slippage is serious, some tax reductions or employment-creating expenditures would be called for. Our goals for economic expansion over the next few years are reasonable and prudent. If the economy falls short of those goals, we will have to revise our budget policies to encourage a return to full employment.

Practically speaking, how do we build budget and economic policies that keep these constraints in mind? We begin by asking whether the private economy will, indeed, grow strongly enough in the years ahead to enable us simultaneously to achieve full employment and a balanced budget by 1981.

We are able to estimate the level of Federal revenues in 1981 under existing tax laws, if the economy achieves our output and employment goals. The Office of Management and Budget also has projected

expenditures under Federal programs including some, though not all, of the proposals that have been put forward by the Administration. On the assumption that no further changes are made in tax laws, Federal budget receipts in 1981 would exceed those expenditures by about \$25 to \$30 billion. That "leeway" could be used for tax reduction or high priority program expenditures, or some combination of both, while still providing for a balanced budget. These resources can be augmented to the extent that efficiencies achieved through zero-base budgeting enable us to free up additional funds.

In principle, we could balance the budget at higher levels of expenditures by raising tax rates. But we believe that it is appropriate to reduce somewhat the share of the gross national product currently absorbed by the Federal Government. From 1963 until the recession began in 1973, the Federal budget outlays amounted to about 21 percent of GNP. In 1976, the ratio was 23 percent. We would like to return to the 21 percent ratio.

If the size of the Federal budget in a full employment economy is known, we can then deduce the overall growth

in the non-Federal sector of the economy that will be needed to reach high employment levels.

Our forecasting ability is not good enough for accurate predictions of economic performance in particular sectors of the economy three or four years hence. But we are able to make some general observations that highlight those sectors from which the needed growth will have to come.

It is apparent, for instance, that the slowdown in population growth, and the absolute reduction in school-age population, imply a slower rate of growth in public services and facilities provided by state and local governments. That slower growth will probably be reinforced by citizen resistance to higher taxes to pay for new services. As a result, we should expect the state and local sector to provide less stimulus to the economy than it has over the past decade or two.

Reduced population growth also affects the outlook for residential construction. However, rates of family



formation and rising real incomes are expected to be high enough to keep residential construction growing at a somewhat faster pace than total real output through 1981.

The foreign trade sector is not likely to be a significant source of stimulus over the next few years. Recovery in other industrialized countries may proceed less rapidly than in the United States, which will moderate the growth of our exports. And our oil imports will continue to rise for a time until the energy program begins to curtail demands for fuel significantly. The best we can realistically expect is a very modest rise of real net exports.

Consumer spending is the largest component of our gross national product. At the moment, consumers are in a buying mood. During most of the past ten years, however, consumers held back on their spending, in part because of concern with the effects of inflation on the real value of their accumulated savings, and in part because of the uncertainties associated with sharp fluctuations in the economy. During this 10-year period, the personal saving rate averaged 7 percent -- up about 1 percentage point from the prior decade.

If we are successful over the next few years in pursuing a path of stable growth with inflation under control, consumers should remain relatively confident and spend a comparatively high fraction of their incomes on goods and services. We have projected an average saving rate of 6 to 6-1/2 percent over the next four years-

less than the average of the past decade, but higher than the very low levels of the past two quarters.

Most importantly, meeting our economic growth targets over the next few years will require a strong and sustained rise of business fixed investment. These outlays, in real terms, would need to increase at an average rate of about 9 to 10 percent a year between now and 1981. Such a rise would provide the needed thrust on the demand side to reach full employment; it would also ensure the expansion of industrial capacity required to avoid running into capacity bottlenecks.

A growth rate of 9 to 10 percent in business capital outlays over a four or five year period is an ambitious objective, but it is not unprecedented. From 1962 to 1966, business fixed investment increased at an average annual rate of over 10 percent, and carried the economy from a depressed state to very high levels of employment and production.

This economic projection provides the basis for developing our budgetary plans for 1978 and beyond. Our stimulus program for fiscal 1977 and 1978 is designed to get the economy moving forward faster than it grew in 1976, but at a sustainable rate. Over the four quarters of 1977, we expect real GNP to rise about 5-3/4 to 6 percent. This will require a substantial acceleration in the pace of business fixed investment from the sluggish

recovery we have experienced thus far in the current economic expansion. Signs are now emerging that the needed strength of business capital outlays will develop. An evaluation of recent private investment surveys suggests that businesses are planning to increase their plant and equipment expenditures by about 10 percent, in real terms, between 1976 and 1977. Such a strong rise in business capital outlays beginning this year would very likely carry over into 1978, providing reasonable assurance that overall economic expansion would continue to be robust as we move past the current year. The task of economic policy over the longer term is to create an environment in which the improved pace of economic expansion now underway is sustained and carries our economy back to full employment by 1981. And our spending initiatives on the budgetary side must be tailored to live within the constraints of a balanced budget when full employment is achieved.

We must take a long-term perspective toward budgetary planning because decisions today have important effects on Federal budgets as many as five years from now. For example, decisions on defense purchases today will result in a stream of expenditures many years ahead for particular projects. Decisions on welfare reform, social security financing, or tax reform will all affect the budgets of the 1980s. Likewise, the President's energy program will have an impact on spending and on revenues for many years ahead.

Only by taking a long-range view of revenues and spending can we set priorities and make choices among competing demands on Federal resources. Unless we plan ahead, and tailor our budgets to reach the eventual goal of a balanced budget in a full employment economy, we will find it very difficult to reverse a trend toward deficits at later dates. The \$25 to \$30 billion by which revenues in 1981 are projected to exceed outlays, assuming tax and spending policies remain the same and we reach full employment, is small leeway. To meet our target will require constant budgetary discipline and tough political and economic choices throughout the President's term in office.

By aiming our economic and budget policies at these specific goals, we are implicitly recognizing another reality: There is an asymmetrical relationship between adding to and cutting back budget deficits. This is true, in part, because budgeted funds often are committed in advance, so that cutbacks in one year do not affect actual expenditures until sometime later. The major reason, however, is that in the political world it is always easier to increase spending or reduce taxes to stimulate the economy than it is to apply the fiscal brakes. The budget strategy we are pursuing provides us with maximum flexibility to manage the economy responsibly.

If the private economy grows strongly in the next four years, it is critical that we balance the Federal budget as we approach full recovery in 1981. To do otherwise, as I stated earlier, would run the risk of overheating the economy and generating accelerating inflation. We have only partially recovered from the painful inflationary experience of 1973-74, and we cannot afford to permit excess demand to emerge when the economy reaches full employment. The real danger of an unbalanced budget at full employment is not the deficit itself, but the risk that the deficit will rejuvenate inflationary forces and subsequently lead to a recession.

But we retain flexibility in the other direction. If the private economy should prove weaker than we anticipate, so that our goal of full employment in 1981 appears threatened, the strategy permits us to add additional stimulus later in order to put the economy back on the proper track. We must be fully prepared to reduce taxes or to increase spending if it appears that the economy is falling significantly short of the targets we have set.

If we plan now to balance the budget in 1981, counting on a strong private economy, and we are proved wrong about the strength of the economy, it is relatively easy to correct our mistake with appropriate stimulative actions. But if we plan now to run a large deficit in 1981, counting on a weak economy, and are proved wrong, cutting back expenditures or raising taxes to prevent an overheated economy would prove vastly more difficult.

Our long-run budgetary strategy also has important implications for the economic problems that we face today. The current deficit in the Federal budget is not in any basic sense inflationary, because it is occurring at a time of substantial slack in the economy. Current deficits could give rise to inflationary expectations, however, if they were taken by the public as a sign that the government would continue to run large deficits once the economy returns to high employment. And such expectations might particularly dampen investment spending. It is important, therefore, to put forth our plans for a balanced budget in a recovered economy in order to dispel those fears.

We believe, therefore, that a planning strategy that seeks to attain a balanced budget in a high-level economy is appropriate and prudent. This is not a matter of putting balanced budgets ahead of everything else. Nor does it reflect blind faith in forecasts of a strong private economy. Rather, it arises from a sober recognition of the political and economic realities of the budget process.

~~CONFIDENTIAL~~

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Hamilton Jordan -

The attached was returned in  
the President's outbox. It is  
forwarded to you for appropriate  
handling.

Rick Hutcheson

Re: October 1 Birthday Party &  
Fund Raiser for DNC

DETERMINED TO BE AN ADMINISTRATIVE  
MARKING BY Jay DATE 9/22/89



*Have -  
Comment -  
Be Careful  
J*

MEMORANDUM

THE PRESIDENT HAS SEEN.

TO THE PRESIDENT

FROM GERALD M. RAFSHOON

DATE May 13, 1977

RE OCTOBER 1 BIRTHDAY PARTY AT MADISON SQUARE GARDEN  
IN CONJUNCTION WITH A FUND RAISER FOR THE DNC AND  
THE PRESIDENT'S COMMISSION ON MENTAL HEALTH

We have been exploring a DNC fundraiser to celebrate your birthday. Originally a closed circuit gala-type event was the direction we were taking. But we have been approached by CBS for something new and happened to mention that we were working on this event. They were very interested if we could separate the entertainment from the fund raiser. We have. We've separated the dinner and the entertainment so that they just happen to be taking place in the same location -- Madison Square Garden. (This is the sight of JFK's memorable birthday party where Marilyn Monroe sang happy birthday.)

The gala production will be under the direction of the same people with all the profits being donated to the President's Commission on Mental Health. The DNC dinner will take place immediately following in an adjacent room.

On the evening of the first, a proposed schedule will be: 6:30 - 8:30 p.m., the Birthday Party Gala in the main arena of Madison Square Garden; 8:30 - 9:30 p.m., a dinner with you and the entertainers in The Rotunda of the Garden -- 2,000 people at \$1,000 per plate.

CBS is very anxious to negotiate. The DNC is very eager and we have spoken to Dr. Bryant and he is very receptive to the idea if it meets with your approval. I think this could be a chance to help all parties involved and to share another significant event and worthwhile cause with millions of Americans through the use of TV.

The \$2,000,000 target, with little or no downside risk for the DNC, can be reached. The proceeds would get the DNC almost out of debt -- a debt that I am personally concerned about.

**Electrostatic Copy Made  
for Preservation Purposes**



THE WHITE HOUSE  
WASHINGTON  
May 19, 1977

Hamilton Jordan

The attached is forwarded to you  
for your information.

Rick Hutcheson

Note: This will go in to the  
President by Noon today.

Re: Orderly Marketing Arrangement  
for Color TV's.

---

THE WHITE HOUSE  
WASHINGTON

May 19, 1977

Secretary Blumenthal  
Stu Eizenstat  
Charlie Schultze  
Robert Strauss  
Jack Watson

Re: Orderly Marketing Arrangement  
for Color TVs

The attached was returned in the President's  
outbox and is forwarded to you for your  
information and appropriate action.

The original memorandum to the Special  
Representative for Trade Negotiations  
has been given to Bob Linder for appropriate  
handling.

Rick Hutcheson

cc: Bob Linder

5/19 +  
12

THE WHITE HOUSE  
WASHINGTON

*cc Blumenthal  
Mr Ernie Preeg  
PREEG  
Am 351*

ACTION  
FYI

<input type="checkbox"/>	MONDALE
<input type="checkbox"/>	COSTANZA
<input checked="" type="checkbox"/>	EIZENSTAT
<input type="checkbox"/>	JORDAN
<input type="checkbox"/>	LIPSHUTZ
<input type="checkbox"/>	MOORE
<input type="checkbox"/>	POWELL
<input checked="" type="checkbox"/>	WATSON

<input type="checkbox"/>	ENROLLED BILL
<input type="checkbox"/>	AGENCY REPORT
<input type="checkbox"/>	CAB DECISION
<input type="checkbox"/>	EXECUTIVE ORDER
	Comments due to Carp/Huron within 48 hours; due to Staff Secretary next day

<input type="checkbox"/>	FOR STAFFING
<input type="checkbox"/>	FOR INFORMATION
<input checked="" type="checkbox"/>	FROM PRESIDENT'S OUTBOX
<input type="checkbox"/>	LOG IN/TO PRESIDENT TODAY
<input type="checkbox"/>	IMMEDIATE TURNAROUND

<input type="checkbox"/>	ARAGON
<input type="checkbox"/>	BOURNE
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<input type="checkbox"/>	SIEGEL
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<input checked="" type="checkbox"/>	STRAUSS
<input type="checkbox"/>	WELLS
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THE WHITE HOUSE  
WASHINGTON

Mr. President:

Eizenstat comments are  
attached, along with  
STR and CEA memos.

If you approve the OMA  
negotiated by Strauss,  
STR requests that you  
indicate your approval  
by signing the memo  
attached at the end of  
the packet, so that this  
may be shown to the  
Japanese at the signing  
planned for tomorrow.

Rick



THE SECRETARY OF THE TREASURY  
WASHINGTON 20220

PRIORITY

*Accept Strauss  
agreement*

May 18, 1977

1977 MAY 18 PM 1 17 J.C.

MEMORANDUM FOR THE PRESIDENT

FROM: W. MICHAEL BLUMENTHAL  
CHAIRMAN, ECONOMIC POLICY GROUP *WMB*

SUBJECT: ORDERLY MARKETING ARRANGEMENT FOR  
COLOR TV's

Last March the ITC recommended significant tariff increases as import relief for the color TV industry. By May 21 you are required by law to announce whether you intend to give import relief and, if so, the type of relief you will provide. You have already given Bob Strauss instructions to seek an orderly marketing agreement (OMA) with Japan. This week the EPG reviewed the OMA which was recently negotiated ad referendum.

This OMA would regulate imports from Japan at 1.75 million TV sets for three years beginning this July (compared with 2.6 million sets in 1976). Of this, 1.56 million would be completed sets and 190,000 would be assembled sets requiring some U.S. labor input. The details of the OMA are further spelled out in the Strauss memorandum to you on the subject. Strauss believes that it is a balanced agreement that will satisfy the industry, the unions, and consumers. He underlines the point that the OMA will have the effect of accelerating Japanese subsidiary production in the U.S. and production by domestic firms, which in turn will generate jobs and provide adequate supply to hold down prices. In his judgment, inflationary impact would be minimized because inventories built up in the U.S. in anticipation of restrictions will be drawn down during the first year, and added productive capacity from Japanese investment in U.S. assembly plants will be available in the second year.

CEA, Treasury, and State have reservations about the economic impact of the agreement. These are elaborated in a separate CEA memorandum. There is concern that the agreement contains no provisions for



growth of Japanese imports in its second and third years. The reasoning is that domestic demand will likely increase substantially and that unless domestic output can continue to grow rapidly, prices of color TV's will be driven up sharply in late 1978 and 1979. These agencies are reluctant to rely on increased Japanese production in the U.S. for the added supply. They therefore propose that the agreement be concluded for only a 2-year period and that it be amended to allow for modest growth in imports in the second year, perhaps from 1.75 million sets to 2.0 million sets.

#### OPTIONS

1. Accept Strauss agreement for three year OMA without growth formula. In this case Strauss would sign the agreement as it now stands.

Labor, Commerce, OMB and STR support this option. NSC also supports it on the judgment that this is an opportunity to establish some credibility with domestic interest groups without adverse foreign policy consequences.

APPROVE \_\_\_\_\_ DISAPPROVE \_\_\_\_\_

2. Amend the OMA to be a 2-year agreement with allowance for some growth in the second year. There would be no problem in renegotiation since the revised agreement would be more favorable to Japan. New language could therefore be substituted in the existing agreement and the announcement could be made on time.

Opponents of this option believe that if the negotiated agreement is amended now, the STR's credibility in future negotiations with Japan would be impaired.

CEA, Treasury and State support this option. (State is prepared to forego growth in the second year.)

APPROVE \_\_\_\_\_ DISAPPROVE \_\_\_\_\_

Attachments

THE WHITE HOUSE

WASHINGTON

May 19, 1977

MEMORANDUM FOR:

THE PRESIDENT

FROM:

STU EIZENSTAT  
BOB GINSBURG

*Stu*

SUBJECT:

Orderly Marketing Agreement  
For Color TVs

We recommend that you approve the OMA for color TVs negotiated by Ambassador Strauss with the Japanese:

1. U.S. imports of color TVs from Japan surged from 1.05 million in 1975 to 2.7 million in 1976. This is a classic case of a sharp and disruptive increase in imports. The OMA calls for a quota of 1.75 million sets for each of the next three years. Although this is a cutback from the record level of 1976, it still represents considerable market growth for the Japanese as compared to the 1972-1975 period.
2. In the shoe case, the domestic industry has been losing ground in a fair competitive process to more efficient foreign producers. In this case, Japanese trading practices (which have included dumping and hidden rebates to U.S. importers) have constituted a gross departure from any kind of reasonable norm for free and fair international trade practices.
3. The Japanese are apparently satisfied with the OMA. If you reject this agreement and instruct Ambassador Strauss to go back and come up with an agreement more favorable to the Japanese, it could put all our foreign economic negotiators (not just Ambassador Strauss) in very difficult positions -- our trading partners will always hold out for more. This could adversely affect U.S. bargaining ability and results in the MTN and other important international economic negotiations.

4. The reaction of the domestic industry and unions even to this OMA will be lukewarm. There would be bitter resentment (and threat of a Congressional override) if you reject this agreement and seek one even less beneficial for the domestic industry and unions. It would seem extremely counterproductive in terms of domestic relations to now seek an agreement "easier" on Japan than she herself was willing to accept.
5. The inflationary threat from this OMA is speculative. With existing duties (5% tariff, 20% bond for potential antidumping liability, and 15% bond for potential countervailing duty liability), the Japanese would probably be reducing their color TV exports to the U.S., and moving some of their production facilities to the U.S., in any case. Accordingly, the quotas in the OMA may not really have that much of a restrictive impact. In any event, if domestic color TV prices do start moving up sharply, the OMA can be liberalized or terminated.

In short, we think that the costs of rejecting this OMA would be substantial and far outweigh any potential benefits.



THE SPECIAL REPRESENTATIVE FOR  
TRADE NEGOTIATIONS  
WASHINGTON

CONFIDENTIAL

May 17, 1977

MEMORANDUM FOR THE PRESIDENT

FROM : Robert S. Strauss *RSS*

SUBJECT: Color Television Receiver Agreement with Japan

We have successfully negotiated an agreement with the Government of Japan on color television receivers which I believe will alleviate the problems of the domestic unions and industry while not impairing Japanese participation or generating inflationary pressures in the U.S. market.

The agreement provides for exports of complete and incomplete (meaning almost complete) color television receivers in the amount of 1.75 million per year from July 1, 1977 through June 30, 1980. While these levels appear to be a significant cutback from 1976 imports of around 2.6 million they are more than 50 percent above 1972-75 average annual import levels and, in fact, there is very little restrictive effect in terms of the impact on the U.S. market. The Japanese industry has admitted on the public record that a significant part of the growth of imports in 1976 was due to inventory buildup. Our estimates suggest that 500-700 thousand receivers imported in 1976 went into inventories. Thus the impact of Japanese imports in the U.S. market in 1976 was on the order of two million receivers or less. The replacement of complete set imports by sets assembled by Japanese subsidiaries in the United States should be on the order of 400 thousand receivers in 1977 so that a level of 1.6 million receivers imported from Japan in 1977 would have essentially the same impact as 1976.

We estimate that 1977 imports from Japan will be on the order of two million receivers representing substantial growth in Japanese imports in the market as compared with 1976 even if Japanese affiliate production is not counted. Japanese participation will be even higher than the import level suggests due to inventory buildup prior to the effectiveness of the agreement on July 1, 1977 and inventory drawdown after that date. We believe several hundred thousand receivers have been stocked at a minimum, in anticipation of restrictions.

Impact on Japan

The Japanese apparently feel that the agreed levels will be sufficient to permit them to participate in an acceptable

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Per: Rac Project  
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B: *On* 11/3/12



way in the U.S. market. The Japanese predict that their own television industry will move off shore over the next five years. There will be three incentives for the Japanese to come into the United States to invest in assembly operations: (1) quantitative restrictions in the agreement; (2) the potential antidumping duty liability (now requiring posting of a 20 percent bond); and (3) potential countervailing duty liability (now requiring posting of a 15 percent bond). The Japanese were offered an option that provided a slightly smaller first year restraint level than 1.75 million but with growth in later years; however, they preferred the current deal.

Three companies are already operating in the United States and these firms will be expanding production in 1977 and 1978. Two other Japanese companies are on the verge of starting production in the United States and are likely to make substantial additions to domestic production capacity in the United States.

As the definition used for the scope of the agreement will permit importation of Japanese components and subassemblies without restriction, there will be no pressure on domestic U.S. capacity in these areas and the Japanese firms will still realize substantial labor input in their own country.

#### Impact on U.S. Industry and Unions

The level of restraint in the agreement is well above that requested by the domestic industry and unions but can be sold to them on the grounds that they will enjoy the benefits of growth in the domestic color television market. The unions will benefit even where such growth is a result of the operation of Japanese affiliates since such affiliates will generate substantial labor content in the United States. The risk for domestic producers will be that the market will not increase as expected due either to economic problems (which seem unlikely) or competition for the consumer dollar by other products such as video recorders.

In addition to this problem, the risk for unions is that American companies will continue to move their component and subassembly operations off shore. This is an inevitable trend in the industry but its effects will be moderated by the agreement because Japanese companies will be locating assembly plants in the United States.

I believe this agreement can be successfully sold to the domestic industry and unions and I would expect only mild Congressional reaction, if any.

The unions will privately be pleased and publicly say "while it's a good step in the right direction it should have gone farther in reducing imports."



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### Effect on Consumers

We would expect only minimal effects on the pricing and availability of color television receivers as the result of the orderly marketing agreement for the following reasons:

1. There is considerable excess capacity domestically (e.g. about 30 percent in 1976).
2. We expect that capacity and production will be expanded by Japanese firms in the United States in the near future and expansions by domestic producers would also be likely. The lead time for such investments is relatively short because of the assembly nature of TV receiver production.
3. Imports from countries other than Japan will be permitted to increase so long as Japanese producers are not disadvantaged. The United States Government will determine if restrictions on such imports are appropriate.
4. We estimate that there are substantial excessive inventories at both wholesale and retail levels in the near term which will assure adequate supplies under expected market conditions. There is also the one million sets coming in prior to the effective date of the agreement (from Jan. 1, 77 to Apr. 1, 77).
5. We will monitor prices and market conditions throughout the period of the agreement and can liberalize or terminate the agreement if conditions warrant such actions.

### Status

The Japanese are prepared to sign this agreement on May 20 following authorization by their cabinet and by you to proceed. I am convinced that this is a fair and balanced agreement which can be accepted by the Japanese and our domestic interests.

Attached is a description of the elements of the draft agreement which has been initialed on an ad referendum basis (Attachment A).

Your decision is required by May 21, 1977 and I would need your authorization to sign the agreement by the 19th of May. A directive to me implementing this recommendation is provided in Attachment B.

CONFIDENTIAL

Elements of Color TV Agreement with Japan

I. Exchanges of Notes constituting an orderly marketing agreement

Coverage: Mainly complete and fully assembled color television receivers, but also including incomplete and partially assembled color television receivers that are substantially complete. (This latter category has not been historically important in U.S. TV imports; however, including these incomplete but substantially complete receivers in the coverage of the agreement affords some protection from circumvention of the intent of the agreement by the importation of TV receivers that require very little U.S. labor for their final assembly).

Timing: Three years, July 1, 1977 to June 30, 1980

Restraint Levels: 1.75 million color television receivers each year divided between 1.56 million complete receivers and 0.19 million incomplete receivers.

Other Countries: U.S. has authority to restrict other foreign suppliers if they increase exports to the disadvantage of Japanese exporters.

II. Japanese side letter on investment

- Japanese Government will guide its color TV producers to provide significant labor content in production operations to be located in the United States.

III. U.S. side letter on pending trade cases

- U.S. informs Japan of its position with respect to other color TV trade cases pending.

IV. U.S. transmittal of Justice memo on antitrust

- Provides Justice Department opinion that agreement provides antitrust protection to Japanese firms in carrying out provisions of the agreement.



~~CONFIDENTIAL~~

ATTACHMENT B

Decision Memorandum on Television Receivers

TO : The Special Representative for Trade Negotiations  
SUBJECT: Import Relief Determination Under Section 202(b)  
of the Trade Act of 1974: Television Receivers

Pursuant to Section 202(b)(1) of the Trade Act of 1974 (P.L. 93-618), I have determined the actions I will take with respect to the report of the United States International Trade Commission (USITC) dated March 22, 1977, concerning television receivers, color and monochrome, assembled or not assembled, finished or not finished, and subassemblies thereof. In that report the Commission determined that color television receivers, assembled or not assembled, finished or not finished, provided for in item 685.20 of the TSUS are being imported into the United States in such increased quantities as to be a substantial cause of serious injury to the domestic industry producing articles like or directly competitive with the imported articles. Three Commissioners found injury in both the color and monochrome television industries.

Pursuant to Section 330(d) of the Tariff Act of 1930, as amended, the President may accept, in the case of an evenly divided USITC vote on an injury determination, the determination of either set of Commissioners on the question of injury. I have decided to accept the determination of those three Commissioners who voted that the domestic monochrome television industry has not been seriously injured or threatened with

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BY: [Signature] DATE: 11/2/13

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- 2 -

serious injury by increased imports. Import relief is therefore not authorized for this industry under section 203 of the Trade Act of 1974. I have, however, decided to accept the determination of those three Commissioners who voted that the domestic industry producing subassemblies of color television receivers has been seriously injured by increased imports.

Pursuant to section 202(b)(1) of the Trade Act, I have determined to provide import relief to the television industry producing color television receivers, assembled or not assembled, finished or not finished and subassemblies thereof provided for in item 685.20 of the TSUS.

I am, therefore, directing you to negotiate and conclude an orderly marketing agreement with the Government of Japan, the major supplying country, to resolve the immediate problems of our domestic color television industry for a three year period which will provide the domestic industry time to remedy the injury found to exist.

This determination is to be published in the Federal Register.

CONFIDENTIAL



THE CHAIRMAN OF THE  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON

May 17, 1977

MEMORANDUM FOR THE PRESIDENT

FROM: Charlie Schultze *CS*  
SUBJECT: Import Relief for the Color Television Industry

Bob Strauss has negotiated an orderly marketing agreement with the Japanese covering color television sets. The agreement would establish a quota on imports from Japan of 1.75 million sets per year for a 3-year period beginning July 1 of this year. Imports from Japan in 1976 were 2.7 million sets.

In the first year of the agreement, expansion of domestic production within existing capacity and a rundown of inventories of imported sets ought to be sufficient to satisfy projected demand. However, in the second and third years of the agreement domestic output will have to continue to grow rapidly, or prices of color televisions will be driven up sharply. For example, with a 1.75 million quota, domestic production of small-screen sets would have to rise from 3.3 million sets in 1976 to about 4.7 million in the second year of the agreement and to 5.3 million in the third year. This compares with a prior peak, in 1973, of 4.1 million small-screen sets; and there has probably been a decline in capacity since then.

A substantial increase in final assembly in the United States by Japanese manufacturers might avoid the problem. But it is very risky to rely on this. It remains in doubt whether the domestic industry will be able to satisfy the growth in demand in the second and third years of the agreement.

Import quotas, which place restrictions on quantities supplied, push all of the uncertainty in the market onto the price. Hence, it is important in our fight against inflation not to become committed to long-term quantity restrictions.

I propose that the agreement be concluded for only a 2-year period and that it be amended to allow for modest growth in imports in the second year, say, from 1.75 million sets to 2.0 million sets. A 2-year agreement would allow the color television market to become

stabilized and provide an opportunity for U.S. producers to become competitive with foreign producers. If they are unable to do so, domestic capacity will not expand, and a quota that continued to hold down the growth of imports for a third year would be very inflationary. Moreover, it would be much easier to conduct an objective review of the need for import relief in the summer of 1979 than in the summer of 1980.



THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR

The Special Representative for Trade Negotiations

SUBJECT: Import Relief Determination Under Section 202(b)  
of the Trade Act of 1974: Television Receivers

Decision Memorandum on Television Receivers

Pursuant to Section 202(b)(1) of the Trade Act of 1974 (P.L. 93-618), I have determined the actions I will take with respect to the report of the United States International Trade Commission (USITC) dated March 22, 1977, concerning television receivers, color and monochrome, assembled or not assembled, finished or not finished, and subassemblies thereof. In that report the Commission determined that color television receivers, assembled or not assembled, finished or not finished, provided for in item 685.20 of the TSUS are being imported into the United States in such increased quantities as to be a substantial cause of serious injury to the domestic industry producing articles like or directly competitive with the imported articles. Three Commissioners found injury in both the color and monochrome television industries.

Pursuant to Section 330(d) of the Tariff Act of 1930, as amended, the President may accept, in the case of an evenly divided USITC vote on an injury determination, the determination of either set of Commissioners on the question of injury. I have decided to accept the determination of those three Commissioners who voted that the domestic monochrome television industry has not been seriously injured or threatened with serious injury by increased imports. Import